B5350-2

MANUFACTURERS HANOVER

Financial Digest

Volume XXVII, Number 16 Monday, July 30, 1990

Analysis of Business Trends Plus Selected Financial Indicators

"High-Yielding" Currencies Take Center Stage

Despite the monumental economic and political changes occurring around the world this year, the foreign exchange markets have been relatively quiet, at least with respect to the U.S. dollar, the German mark and the Japanese yen. In fact, things have been so uneventful in the major markets this year that the topic of currency trends, usually one of the hottest issues at the yearly Group-of-Seven Summit meetings, never even came up in Houston this month. The market's stability, however, is not due to any policy actions by the leaders of the major industrial countries. Rather, it reflects a reluctance by market participants to either buy or sell the major currencies because of widespread confusion about interest rate policies in the United States, Germany and Japan, as well as uncertainty about the ramifications of current events in Eastern Europe and the Soviet Union.

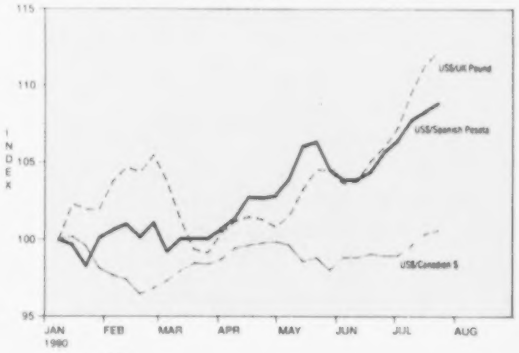
The lack of movement in the major markets has caused traders to seek out the currencies of high interest rate countries in order to earn profits on the differentials relative to lower-rate countries. As a result, despite the severe economic problems in some of these countries—which is why their interest rates are so high to begin with—strong demand has caused the "high-yielding" currencies to appreciate sharply in recent weeks (see chart).

The currency that has benefitted the most from the markets' focus on the high-yielding currencies is the U.K. pound. Propelled by the country's 15 percent interest rates, the pound has soared above $1.81, its strongest level against the dollar in 18 months, despite the U.K.'s lofty inflation rate, hefty current account deficit and slow economic growth. Market expectations that the pound will soon join the exchange rate mechanism of the European Monetary System (EMS) has added fuel to the fire. This is because EMS membership confines a currency to specific trading ranges, thereby limiting the risk of owning such a currency if it suddenly undergoes hefty selling pressure.

Governments Face Policy Dilemmas

While a strengthening currency has been a welcome support to the U.K. government's inflation-fighting program, other countries have not been so pleased. Indeed, when a currency rises solely on the basis of favorable interest rate differentials, it can cause major headaches

SELECTED HIGH-YIELDING CURRENCIES
(JANUARY 5, 1990 = 100) <WEEKLY AVERAGES>



Source: MH

for a nation's economy. Because Australia is a commodity-based economy, movements of the Australian dollar generally follow commodity price movements. However, while commodity prices have been falling lately, and Australia continues to run a huge current account deficit and a big foreign debt, the Australian dollar is trading near a 15-month high against its U.S. counterpart. As a result, Australian farmers not only have to cope with lower world prices for their commodity exports, but they also receive fewer Australian dollars when they convert U.S. dollars into local currency.

Lower export earnings are not the only problem that an unjustifiably strong currency can cause a country. Fueled solely by a record differential of almost six percentage points between Canadian and U.S. interest rates in Canada's favor, the Canadian dollar has climbed to a ten-year high of nearly US$0.87, as traders shrugged off Canada's economic problems and recent political upheavals. Although a sharply weakening economy is expected to force the Bank of Canada to ease monetary policy later this year, the central bank will have to be extremely cautious if it is to avoid a re-

Manufacturers Hanover Economics Department 17/270

Copyright 1990 Manufacturers Hanover Corporation 270 Park Avenue, New York, NY 10017

peat of what happened last February. At that time, signs of an economic slowdown prompted the Bank of Canada to implement a modest reduction in interest rates. Because lofty interest rates were its sole support, the Canadian dollar plunged, forcing the central bank to hike interest rates back up again to even higher levels than before, bringing the economy, it is widely feared, to the brink of recession.

Tensions Within The EMS

The market's fixation with high-yielding currencies is also producing strains within the EMS, causing monetary policy dilemmas for the member central banks. Strong demand for the high-yielding Italian lira and Spanish peseta has forced their central banks to intervene heavily in the foreign exchange markets in order to keep them within their permitted EMS trading ranges. In fact, to diminish the lira's attraction, the Bank of Italy cut its discount rate by a full percentage point in May, despite Italy's relatively high inflation rate. Although the lira is still brushing up against its upper EMS trading limits, the Bank of Italy's ability to cut interest rates further is limited by the Italian Treasury's hefty borrowing requirements this year.

The Bank of Spain is facing a similar dilemma. While it wants to maintain a tight monetary

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/11/90)	217,502	+ 434	- 1,432
New York City (7/18/90)	39,617	+ 439	- 3,335
Commercial Paper (7/18/90)	542,921	+ 4,013	+ 40,375

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/11/90)	321,980	- 964	+ 6,754
New York City (7/18/90)	57,708	+ 671	+ 369

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/11/90)	1,011,822	- 2,937	+ 43,314
New York City (7/18/90)	183,064	+ 4,258	+ 7,286

Financial Markets

	Friday 7/27/90	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.75%	- .02	- .36
180-Day Bills†	7.78	- .04	- .10
Longest Bills†	7.77	- .04	- .09
Recent Issues:			
8s 7/31/92 (When Issued)	7.98	NA	
8½s 6/30/94	8.18	- .04	
8⅞s 5/15/00	8.42	- .03	
8¾s 5/15/20	8.49	- .04	
Municipals:			
Bond Buyer—20 Bond Index* (7/26/90)	7.15%	- .02	+ .20
Blue List Total ($ Million)	$1,114	- $ 87	- $ 521
30-Day Visible Supply ($ Million)	$1,316	+ $ 27	- $1,578
Total	$2,430	- $ 60	- $2,099
Corporates:			
Moody's Aa Composite (7/26/90)	9.46	- .01	+ .38
30-Day Visible Supply ($ Million)	$ 250	- $520	- $3,820
Stocks:			
Dow-Jones Averages:			
Industrials	2,898.52	- 62.62	+263.28
Transportation	1,134.67	- 24.64	- 134.53
Utilities	203.35	+ 1.20	- 16.47
65 Stocks	1,027.28	- 17.91	+ 4.98
N.Y.S.E. Composite Index	193.32	- 4.33	+ 2.94
N.Y.S.E. Avg. Daily Vol. for Week (000's)	171,970	+ 5,014	- 7,819

*34% Taxable equivalent 10.83%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/27/90	Week Ago
Overnight	7.94%	7.94%
1 month	8.13	8.00
3 month	8.13	8.00
6 month	8.13	8.06
1 year	8.13	8.13

FOREIGN EXCHANGE SPOT RATES New York Opening (7/27/90)	Currency Per U.S. $	Week Ago
Belgium	33.37	33.84
Canada	1.1531	1.1533
France	5.4335	5.5085
Germany	1.6207	1.6425
Italy	1187.00	1202.70
Japan	150.70	148.95
Mexico	2845.00	2839.40
Netherlands	1.8268	1.8498
South Korea	707.26	707.26
Switzerland	1.3690	1.4065
Taiwan	26.80	26.85
U.K.*	1.8255	1.8160

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (7/27/90) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.5%	-3.3%

policy in order to fight inflation and cool import demand (Spain has the highest inflation rate and largest current account deficit in the EMS), the peseta's strength could force the central bank to cut interest rates in order to keep the currency within its allowable trading ranges.

The market's preoccupation with high-yielding currencies is also causing problems for EMS member countries with sound economic policies, good fundamentals and, consequently, relatively low interest rates. The weakness of the low-yielding guilder within the EMS forced the Dutch central bank to raise domestic money market interest rates earlier this month, although the Netherlands has the lowest inflation rate of any EMS member country.

While the French franc is trading at a 2½-year high against the Deutschemark and France's inflation rate should soon fall below Germany's for the first time since 1966, the government is unable to lower French interest rates because the franc is trading at its lowest permissible levels against the lira and the peseta. For the moment at least, market demand for the high-yielding currencies will continue to cause headaches for economic policymakers. But when these currencies fall—and they always do—it will be the traders who will feel the pain. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 7/25/90	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	283.135	+ .394	+11.773
Loans to Depository Inst.	1.000	+ .336	+ .325
Float	.820	+ .393	- .030
Total Reserve Bank Credit	278.757	- .561	+19.276
Treasury Deposits with Federal Reserve Banks	5.082	- .026	+ .057
Currency in Circulation	268.463	- 1.043	+19.566
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	226.398	- 2.208	- 10.714
Member Bank Reserves:	**7/25/90**		
Total Reserves Held	58.991	- 1.375	+ .441
Excess (Deficiency)	.837	- .064	- .198
Net Free Reserves	.303	- .199	- .141

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	% Change Since Year Ago
M1 (7/16/90)	807.9	+ 1.9	+ 4.4
M2 (7/16/90)	3,273.7	+ 0.4	+ 5.0
M3 (7/16/90)	4,051.6	- 1.0	+ 1.3
Domestic Nonfinancial Debt (1st Q'90)	9,987.4	+ 7.6	+ 8.1

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 7/27/90	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.52%	7.39%	7.26%
* Federal Agencies	7.90	7.95	8.00
* Municipal Notes–High Grade (34% Taxable Equivalent)	8.52	8.71	8.71
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.03	8.05	7.80

‡ Finance Company Paper–Prime

5- 14 days	7.90%
15- 29 days	7.90
30- 59 days	7.86
60- 89 days	7.78
90-179 days	7.68
180-239 days	7.53
240-270 days	7.53

‡* Bankers' Acceptances

Aug.	7.95%
Sep.	7.86
Oct.	7.82
Nov.	7.78
Dec.	7.73
Jan.	7.69

‡ Industrial Paper–Prime

30- 89 days	7.93%
90-120 days	7.85

†Federal Funds Effective Rate 8.00%

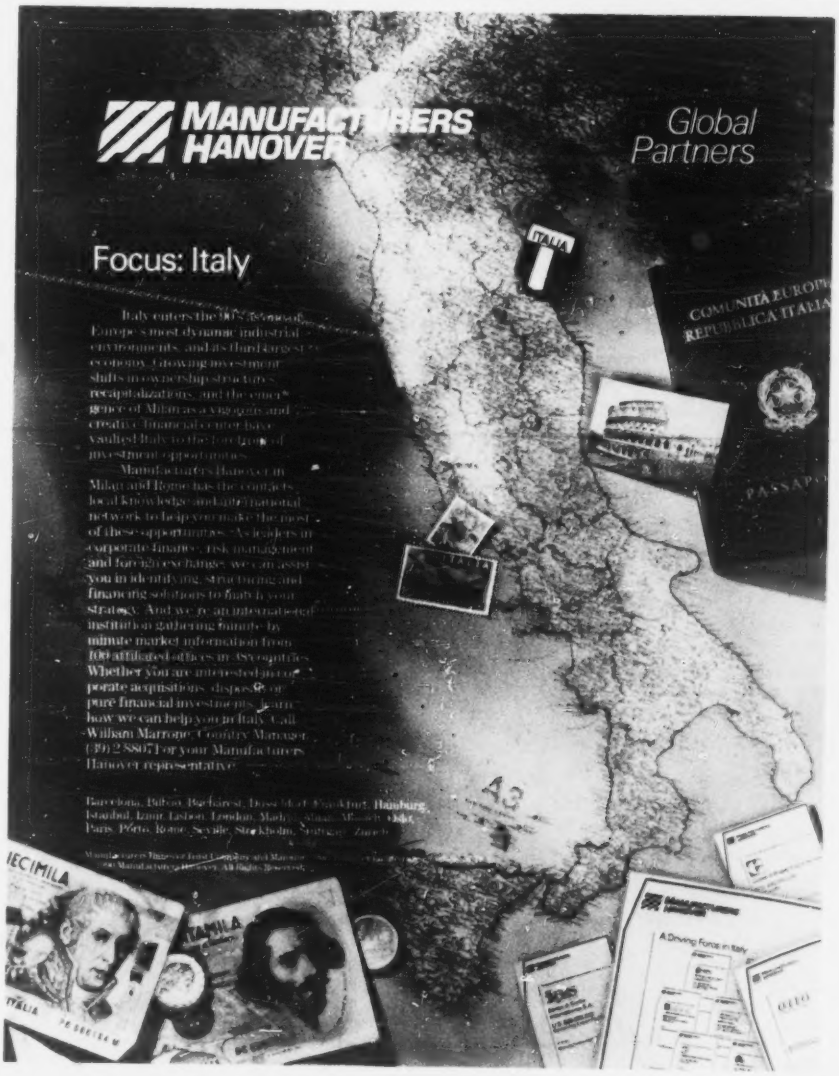
‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'90n	$ 5,452	$ 5,375	$ 5,174
Gross National Product (1982 Dollars)*	2nd Q'90n	$ 4,163	$ 4,151	$ 4,112
Percent Change, Annual Rate	2nd Q'90n	1.2	1.7	1.6
Change in Consumer Prices*	Jun '90n	6.0 %	2.4%	2.4%
Change in MH Cost of Living Index*	Jun '90n	6.0 %	2.4%	3.6%
Change in Producer Prices*	Jun '90	1.2 %	3.6%	3.6%
Civilian Employment (Thousands of Persons) †	Jun '90	118,389	118,350	117,542
Unemployment as % of Civilian Labor Force †	Jun '90	5.2%	5.3%	5.3%
Personal Income*	May '90	$ 4,701	$ 4,687	$ 4,396
Leading Indicators Composite Index (1967=100) †	May '90	146.2	145.1	144.2
Industrial Production Index (1977=100) †	Jun '90n	109.8	109.3r	108.4
Net Change in Consumer Installment Credit †	May '90	$ 3.91	$ 0.39	$ 4.20
U.S. Merchandise Trade Balance †	May '90n	- $ 7.73	- $ 7.31r	- $ 10.26
Plant and Equipment Expenditures*	3rd Q'90	$ 511.6(a)	$ 506.8(a)	$ 484.9
Private Housing Starts (Thousands of Units)*	Jun '90n	1,177	1,205r	1,414
New Construction Expenditures*	May '90	$ 445.6	$ 447.2	$ 434.7
Total Business Inventories †	May '90n	$ 799.4	$ 796.1r	$ 779.1r
Total Business Sales †	May '90n	$ 538.3	$ 533.6r	$ 523.5r

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.



MANUFACTURERS HANOVER

Manufacturers Hanover Corporation
Bank Window, Church St. Station
New York, N.Y. 10015

First Class
U.S. Postage
PAID
Manufacturers
Hanover

00463000024182 C 939 CONGR0001
CONGRESSIONAL INFO SERVICE
ATTN SRI
4520 EAST-WEST HWY
BETESDA, MD 20814

Financial Digest